BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

RATE AND SERVICE CHANGES TO IMPLEMENT FUNCTIONALLY EQUIVALENT NEGOTIATED SERVICE AGREEMENT WITH THE BRADFORD GROUP

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INITIAL BRIEF OF THE BRADFORD GROUP

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STATEMENT OF THE CASE

The terms of this Negotiated Service Agreement (NSA) are familiar: the Postal Service and its customer have reached a customized service agreement that provides a volume block discount incentives on Standard Mail solicitations. This NSA complies with all of the applicable provisions of the Postal Reorganization Act ("PRA"). Moreover, the public policy embodied in the passage of the PAEA promote the Commission's favorable recommendation of this agreement, without qualification.

The Postal Service and the Bradford Group ("Bradford") have established beyond questions that the agreement (i) meets the ratemaking and classification criteria of the PRA, (ii) is not discriminatory, and (iii) is in the public interest. The Postal Service and Bradford have put forward a reasonable and persuasive business case for entering into this deal, and the record fully substantiates this conclusion. This record evidence cannot be overcome by speculative concerns: the PAEA has firmly established the principle of pricing flexibility, and the Commission should not substitute its own business judgment for the judgment of the Postal Service. For these reasons, as detailed more fully in this Brief, Bradford urges the Commission to favorably and unqualifiedly recommend implementation of this NSA.

STATEMENT OF FACTS

A. Description of the Bradford Group

The Bradford Group markets fine collectibles, including collector's plates, miniature buildings, electric trains, ornaments, figurines, and porcelain and vinyl dolls, and other products. BG-T-2 at 1-2. The Bradford Group, and its flagship enterprise, the Bradford Exchange, have been promoting these products to consumers through direct mail letter solicitations and catalogs, and advertising through magazines and the Internet for over thirty years. BG-T-1 at 1.

The market for collectibles generally appears to be flat or declining. The Bradford Group attributes its continued success in the collectibles market to its innovation, product development expertise, responsiveness to customer preferences, and success in managing its operational costs. BG-T-2 at 2. Bradford and its customers value the direct at-home communication, promotion and delivery of the company's products, and the company's 365-day guarantee offered for most of its products. BG-T-2 at 2.

Since the Bradford Group uses the mail so extensively to serve existing customers and reach new customers, postage costs are a major factor affecting the company's ability to grow its business. BG-T-2 at 3. Other factors that influence the company's ability to grow its business (and correspondingly, its mail volumes), are the general state of the economy, which influences the disposable income and income expectations of the target markets, the company's success in the creation and offering of its products, the cost and price of the products, and the cost of printing and paper. BG-T-2 at 3.

Bradford, like Bookspan, applies limited resources to manage a portfolio of marketing channels and programs to promote its products. BG-T-2 at 3. The company uses a significant amount of direct mail, primarily Standard Mail letters and flats. BG-T-2 at 4. Bradford also advertises in magazines and other specialty publications, inserts in newspapers, and enclosures in third-party mailings and shipments (OCA/BG-T2-1.a.), but the vast majority of correspondence between Bradford and its customers takes place through the Postal Service. BG-T-1 at 2.

The Bradford Group spends a significant amount of financial and other resources to acquire each new customer, with the hope that this customer will buy not only one collectible or collection, but additional collectibles or products not necessarily related to their original purchase. BG-T-1 at 3. A successful Standard Mail solicitation that generates a typical customer would result in a mailstream comprised of Business Reply Mail or First Class Mail order(s), a first-class payment request, the initial product shipment, subsequent first-class solicitations requesting payment for continuity product, reply payments (or installment payments), additional continuity product shipments, and up to 40 Standard Mail letter or flat solicitations offering other products and offerings. BG-T-2 at 3-5. The same customer may then generate additional streams of First-Class payment requests, First-Class or Business Reply Mail payments, and product shipments. In addition, product returns are typically paid by Bradford when the customer uses the Postal Service's Bulk Parcel Return Service offered in each parcel, and other incidental First-Class customer correspondence also occurs, such as additional order or account related correspondence (by postcard or letter), or, if needed, collection notices for past-due accounts. BG-T-1 at 4-5.

B. Description of the NSA

In this NSA, the Postal Service provides Bradford with a financial incentive to shift its marketing efforts more heavily to direct mail. In exchange, the Postal Service receives the direct benefit of the revenues from additional Standard Mail letters and flats. The Postal Service also receives the benefit of revenues from additional First Class, Standard Mail and parcel "multiplier mail" that results from each new customer successfully recruited through these incremental solicitations.

The Bradford NSA tracks key features of the Bookspan deal. First, like the Bookspan NSA, the Bradford NSA provides for annual volume block discounts that provide an incentive to the Bradford Group to increase its use of Standard Mail for purposes of selling more of its product to a nationwide customer base. Second, as in the Bookspan deal, the volume commitments in the second and third year are subject to adjustment based on actual experience. Third, the agreement includes safeguards comparable to those established in the Bookspan NSA, that mitigate any risk to the Postal Service.

Key safeguards include:

• an annual volume commitment which must be met before discounts are payable, that is set well above the before-rates forecast;

• an annual adjustment mechanism for those volume commitments, based on actual experience (with an adjustment floor);

• a volume cap (subject to limited adjustment) beyond which no additional discounts can be earned;

• an automatic termination clause if letter volumes exceed 195 million in any one year, or flats volume exceeds 73.5 million in Year 1, 74.5 million in Year 2, or 77 million in Year 3; and

• an unconditional right of termination for both parties with 30 days notice.

Of necessity, certain aspects of the NSA differentiate the Bradford NSA from the Bookspan deal. As further discussed below, while collectively these differences may reasonably have influenced the Commission's decision to review the agreement as a baseline NSA, they do not provide a basis to modify it or recommend against it. The Bradford NSA independently provides an opportunity for gain for all concerned —for the Postal Service, Bradford, and postal ratepayers overall—with minimal risk of loss to any postal stakeholder.

C. Commission Proceedings

Bradford adopts the statement of the proceedings set forth in the brief of the Postal Service.

ARGUMENT

I. The Bradford NSA Meets the Statutory Requirements of the PRA, and the Policies of the PAEA Weigh Heavily in Support of this NSA

The transition provisions of the Postal Accountability and Enhancement Act ("PAEA"), which became law on December 21, 2006, provide that with respect to requests for recommended decisions filed during the first year, the pre-existing statutory provisions and implementing rules shall apply. See 39 U.S.C. § 3622(f). This case was filed on August 3, 2007; therefore, the applicable provisions of the Postal Reorganization Act, 39 U.S.C. § 3622 and 3623 as it existed prior December 21, 2006, remain the core Commission's standards in reviewing this NSA.

The *Bank of America* NSA proceeding was similarly reviewed under PRA standards after the passage of the PAEA. In that proceeding, the Commission further acknowledged that the PAEA was a clear Congressional expression of public policy, and concluded that "the enunciated policies and objectives of that legislation were both material and relevant, and that they should be applied under the aegis of 'such other factors as the Commission deems appropriate.'" *Opinion and Recommended Decision (Released from Protected Conditions),* Rate and Service Changes to Implement Baseline Negotiated Service Agreement with Bank of America Corporation, PRC Docket No. MC2007-1 (October 3, 2007), ¶¶ 4059-4060, citing former 39 U.S.C. §§ 3622(b)(9) and 3623(c)(6). The Commission further recognized that one of goals of the PAEA is to provide the Postal Service with a level of flexibility to set rates and develop classifications, including the ability to enter into mailer-specific agreements that it finds beneficial, and that to provide this flexibility, it is necessary to shift the initial responsibility to review and determine whether or not to proceed with mailer-specific agreements to the Governors of the Postal Service. *Id.*

The Commission set out the general requirements for NSAs in 2002, explaining that the Postal Reorganization Act, 39 U.S.C. §101 *et seq.*, permits the Postal Service to contract with individual mailers if (1) the contract is subject to the usual review procedures for rate and classification changes, (2) the terms of the contract satisfy the general ratemaking standards of the PRA and benefit mailers as a whole, and (3) the rates and services of the mailers specified in the contract are offered "on the same terms to other potential users willing to meet the same conditions of service."[1] Rule 190 of the Commission's Rules of Procedure states that "it shall be the policy of the Commission to recommend Negotiated Service Agreements that are consistent with the statutory criteria, and benefit the Postal Service, without causing unreasonable harm to the marketplace." 39 C.F.R. § 3001.190.

This NSA satisfies all of the applicable ratemaking and classification criteria of the Act. In satisfaction of sections 3922(b)(1) and 3623(c)(1), no evidence has been presented indicating any adverse effect on competitors to either party to the Agreement. The arrangement can be expected to yield a net positive contribution to the Postal service and is thus favorable to the general public and business mail users, § 3622(b)(4); there is thus no question whether the arrangement bears the required attributable and reasonably allocated institutional costs, § 3622(b)(3). Given the expected financial value and negligible risk (if any), especially in light of the thirty day termination provision, the

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1 *Authority of the United States Postal Service to Introduce New Products and Services and to Enter into Rate and Service Agreements with Individual Customers or Groups of Customers: A Report to the Congress by the Postal Rate Commission, February 11, 2002* at 1.

arrangement is highly desirable from the point of view of both the user – Bradford -- and the Postal Service. § 3622(b)(5). The “simplicity of structure for the entire schedule and simple, identifiable relationships between rates and fees” is, quite simply, not applicable to NSAs. § 3322(b)(7). Similar to the Bank of America NSA, this NSA has either no or a *de minimus* effect on the value of the mail service or kinds of mail (§ 3622(b)(2) and § 3623(c)(2)), the importance of classifications with high degrees of reliability and speed of delivery (§ 3623(c)(3)), and the importance of classifications which do not require high degrees of reliability and speed of delivery (§ 3623(c)(4)). Current tariff rates remain available to all users of the mail; thus, this Agreement does not affect “the available alternative means of sending and receiving letters and other mail matter at reasonable costs[.]” § 3622(b)(5). The mail matter sent by Bradford and received by the recipients is generally business related in nature. While Bradford’s collectibles frequently have cultural value, they are not sent via the classes of mail to which the “educational, cultural, scientific and informational” values are traditionally ascribed. § 3622(b)(8).

Nor is there any basis to argue that the agreement provides an unreasonable preference to Bradford, 39 U.S.C. ¶ 403(c), or would therefore cause “unreasonable harm” to the market place. The Bradford Group is unique among its competitors in its use of the mail as an important means of marketing. USPS-T-1 at 14. The volume discounts in the Bradford NSA are reasonably designed to exploit the company’s unique business model, demand characteristics, and market conditions, and to encourage Bradford to enter mail that it would not otherwise have sent. The discounts will result in increased contribution to the Postal Service’s system-wide institutional costs, benefiting the Postal Service and all of its customers. The volume discounts contained in the

Bradford NSA, therefore, have a reasonable basis. Similarly situated mailers will be able to take advantage of these discounts by entering functionally equivalent agreements with the Postal Service.

Furthermore, just as the Commission can and should concern itself (as it does in each NSA proceeding) with whether the NSA under consideration provides that NSA customer with an unreasonable preference, the Commission should not subsequently narrow the definition of "similarly situated" in a way that, as a practical matter, precludes subsequent NSAs from favorable recommendation.

Last, but by no means least, the Commission should continue to act in accordance with Congress's intent that final business judgments concerning the risks and benefits of this NSA rest on the shoulders of the Postal Service. With the passage of the PAEA, Congress has effectively determined that the best interests of the general public lies with allowing the Postal Service to exercise its business judgment.

II. Recommendation of the Bradford NSA Is In the Public Interest

A. The Record Evidence Presented Compels Favorable Recommendation of this NSA

The Postal Service and Bradford have met their burden of coming forward with record evidence to support the legality of the Bradford NSA. The burden of rebutting this demonstration therefore falls upon those who may oppose the NSA.

Absolutely no evidence has been introduced into the record that discredits or rebuts this NSA. Moreover, no party has introduced evidence casting doubt on the reliability of the proponents' testimony. There is no reason whatsoever to doubt the historic information and multiplier description Mr. Gustafson supplied. There is no more reasonable estimate of Bradford's forecasted before-rates and after-rates volumes than those supplied by Ms. Ring, whose lengthy experience and position at Bradford well qualifies her to make such an assessment.

As the Commission knows well, it is bound by the record before it. As further described below, the record in this case establishes the high probability that this NSA will benefit the Postal Service (and, therefore, all users), as well as Bradford. Therefore, the Commission should not allow itself to be swayed by worries about theoretical economic risks. These risks, in any event, have been reasonably controlled for by incorporating firm terms and conditions, including the thirty day termination provision, in the agreement through which the Postal Service can stem any financial loss that might arise well before it becomes significant.

B. The NSA Is Overwhelmingly Likely To Have A Favorable Financial Impact On The Postal Service

The evidence in this case establishes that (1) this NSA will cause Bradford to send more promotional letter mail, thereby providing financial benefits to the Postal Service, and (2) any risks to the Postal Service and other users of the postal system from this deal are negligible.

Witness Gustafson sets forth the historic volumes figures, which influence Ms. Ring's volume forecasts. The figures presented in his testimony are indisputable. They have been fully reconciled with the Postal Service's volumes. These figures show a substantial decline in total solicitation volumes in FY2006 over each of the prior two years, BG-T-1 at 7 (Table 1), which Mr. Gustafson explains corresponds with the postal rate increases of FY2006.[2] Mr. Gustafson also observes that despite the overall decline in solicitation volumes the volume of flats sent in FY 2006 increased. Because Bradford mails over three times as many letters as flats, any increase in historic flats volume is insubstantial relative to the decline shown in total solicitation volume. Regardless, Mr. Gustafson explains the non-price factors to which he attributes the increase: one of its major catalog lines showed vastly improved cost structures in printing and paper. BG-T-1 at 7.

Mr. Parr's independent review of the market environment indicates that Nonstore Retailers including Bradford are losing business to Warehouse Clubs and Superstore retailers, and that shoppers have been turning away from gifts such as collectibles – apparently in favor of consumables, electronics and entertainment. USPS-T-1 at 8-9. It is thus eminently reasonable for the Postal Service and Bradford to have concluded that an incentive would be required for Bradford -- a Nonstore Retailer that primarily markets collectibles -- to increase mail volumes.

With the company's historic response to price increases, and the state of the market environment established, Ms. Ring provides Bradford's best estimate of its before-rate and after-rate volumes for fiscal years 2008 and 2010. Like Bookspan, Bradford advertises its products through various media including Standard Mail letters and flats, print advertising, inserts into newspapers, enclosures in third party mailings and shipments, and through the Internet. Ms. Ring explains how Bradford makes its marketing decisions, addressing the factors that motivate changes in Bradford's mail volume. Bradford does not purport to make a three-year forecast with "great precision."

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2 Mr. Gustafson's view is supported by Mr. Parr's calculation, at the request of the OCA, of the point's own-price elasticity of demand. See OCA/USPS-T-1-14.

See Response to OCA/BG-T2-1d. There are many factors that influence the planning of campaigns, including product performance, and changes in product and advertising costs (including, *e.g.*, paper and postage). Nevertheless, because Bradford plans its campaigns using a finite advertising budget (s*ee* OCA/BG-T2-1) and has considerable experience in the marketplace, it can provide a reasonable forecast of mail volumes sufficient for purposes of estimating the value of this NSA to Bradford and the USPS. There is no evidence challenging these forecasts, and Ms. Ring's expertise cannot be overcome by mere speculation. Regardless, to the extent any unanticipated circumstances arise, the Postal Service has imposed terms on this NSA that fully protect it against forecast error.

The Postal Service estimates it will benefit by $6.6 million in new contribution over the life of the Negotiated Service Agreement, while the value of the total incremental discounts is projected to be $1.2 million, yielding a net financial benefit to the Postal Service of $5.4 million. The discount exposure is negligible. (Mr. Parr puts the value of the total discount exposure for letters and flats at $9,000.) Mr. Parr’s methodology is analogous to that which the Commission reviewed in the Bookspan deal, which was recommended to the Governors. There is no record evidence contesting the validity of this analysis.

As Mr. Parr explains, forecasts are by definition estimates. He therefore performed a sensitivity analysis of the volume forecasts for Year 1 of the Agreement. USPS-T-1 at 13, App. C. His analysis illustrates the financial gains or losses to the Postal Service if the before-NSA volumes were severely over- or under-estimated. He concludes that a net loss to the Postal Service could occur only under “extreme mis-estimation assumptions.” USPS-T-1 at 14. This analysis and conclusion does not take into account the fact that the Postal Service's judicious exercise of its unconditional termination options would shield the Postal Service from unfavorable results. *Id.* Under any plausible scenario, the NSA will yield a net gain in contribution to the Postal Service.

The value of "multiplier mail" to the Postal Service may be more difficult to assess because Bradford's business is not a negative option business like the book clubs. In broader terms, however, Bradford is a continuity business: the very nature of the collectibles business is such that it involves multiple shipments to series or subscription customers who desire to purchase a complete collection of the merchandise Bradford is offering. Moreover, the precise valuation of the multiplier is unnecessary: Mr. Parr does not rely on the multiplier of the incremental solicitation volume in quantifying the anticipated benefits of the NSA to the Postal Service. The fact that some multiplier mail may be eligible for a discount under the terms of the deal (as further addressed in section III below) is thus of no consequence.

C. The Terms Of The Agreement Adequately Protect The Postal Service From Any Financial Exposure

The incentives of this agreement will encourage Bradford to mail additional solicitation letters and flats, generating an increased volume of Standard Mail solicitations which is expected to provide a net benefit to postal finances over the three-year period of the NSA of $5.4 million. USPS-T-1 at 2.

Bradford is required to mail a specified volume commitment in each year before it is eligible for discounts, and this commitment, is set well above Bradford's before-rate volume forecast for FY2008. In the first year of the agreement, Bradford must send 154 million letters and/or 54,500,000 flats in order to obtain a discount on any mail. Absent the discount, Bradford expects to mail 146,500,000 letters and 53,500,000 flats in FY2008, a total of 200,000,000 mailpieces. The first-year commitments are thus above Bradford's before-rates volume forecasts.

Furthermore, the agreement incorporates adjustment mechanisms and termination provisions which protect the Postal Service against any potential forecast error.

An adjustment mechanism for the volume commitments in Years 2 and 3 mitigates the risks associated with any potential forecasting error. USPS-T-1 at 6. As Mr. Parr explains, the volume commitments in Years 2 and 3 of the agreement may adjust up or down depending on the actual volumes mailed in the preceding agreement year. The agreement also incorporates an adjustment mechanism designed to address circumstances of an acquisition or merger that increases the Bradford Group's Standard Mail volumes, or a sale or closure that reduces the company's Standard Mail volumes. *Request*, Att. F at 6.

The termination provisions address unforeseen circumstances. First, the agreement provides the parties with unconditional rights of cancellation with thirty-days notice. *Request*, Att. F at 9; USPS-T-1 at 7. Thus, if unforeseen circumstances arise that may cause this agreement to become unprofitable, or even just less favorable to the Postal Service than not having the agreement, the Postal Service may terminate the agreement with thirty-days notice.

Second, the agreement terminates automatically, and all discounts cease to be earned if Bradford volumes exceed 12 million pieces above the maximum (adjusted) volume of either letters or flats in the top volume blocks. *Request,* Att. F at 10; USPS-T-1 at 7. While the provision also operates as a cap on the potential financial benefits that can accrue to both parties under the agreement, it protects the Postal Service from the risk of changed circumstances. *Opinion and Recommended Decision, Rate and Service Changes to Implement Baseline Negotiated Services Agreement with Bookspan,* PRC Docket No. MC2005-3 (May 10, 2006), ¶ 4028.

Finally, the NSA addresses the unlikely circumstance that Bradford may not enter enough solicitation mail during the first year of the agreement to substantially cover the Postal Service's transaction costs. To protect the Postal Service from this scenario, the NSA includes a penalty clause: if Bradford does not mail at least 166,000,000 million eligible Standard Mail letters and flats during the first year of the Agreement, it is required to pay the Postal Service $200,000. *Request,* Att. F at 2 (¶II.A). This figure represents a reasonable proxy for transaction costs which has been accepted reluctantly by Bradford, and has not been challenged by any party.

These several aspects of the agreement (the volume commitments, adjustment mechanisms, termination provisions, and the penalty clause) are analogous to provisions in the Bookspan NSA, and operate here, as they did in Bookspan, to virtually eliminate any forecast exposure that otherwise might have encumbered the Postal Service's reliance on the company's before- and after-rate forecasts.

III. Any Distinctions Between Bradford and Bookspan Are Rational

In its decision not to treat the agreement as functionally equivalent, the Commission’s Order of September 7, 2007 identified certain aspects of the NSA that differentiate it from the Bookspan deal. These differences included (i) the availability of the discounts to Bradford for all solicitation mail (and not limited to “new” club members who have “agreed to purchase some stipulated minimum number of items….”); (ii) the extension of a discount for flats in the Bradford NSA; (iii) the economic value of Bookspan’s anticipated conversion of flats to letters; and (iv) the fact that some multiplier mail is eligible for the NSA discounts. While collectively these differences may reasonably have influenced the Commission’s decision to review the agreement as a baseline NSA, they do not detract from the financial value of the NSA to the Postal Service, and offer no justification to alter the deal reached by the parties.

Addressing the first of these matters, in his response to Commission Information Request No. 1, Questions 4-5, Mr. Gustafson testified that the Bradford Group cannot readily distinguish between "new" and "existing" customers. Tr. 2/14-15. Therefore the Bradford NSA could not limit discounts to “new” customers in any sense. The Postal Service has nonetheless determined – and there is no record evidence to the contrary – that the deal offers it favorable financial benefits.

As to the second and third of these matters (the discount incentive for Bradford to mail Standard Mail flats, and the corresponding lack of economic value associated with potential conversion of flats to letters), the NSA arguably offers a more predictable effect on the volume that will be subject to the agreement, because unlike Bookspan, Bradford has no plans to shift flats to letters. There is thus one less variable that could significantly influence the total volume of mail subject to the agreement, and the resulting value of the agreement to the USPS. The NSA provides the incentive needed to enable Bradford to increase all of its Standard Mail volume.

Finally, the fact that some multiplier mail will likely be eligible for a discount does not detract from either the quantified financial benefits of the deal to the Postal

Service, or the qualitative value of the multiplier mail. Mr. Gustafson cogently explains that Bradford's incremental solicitation volume will result in valuable multiplier mail. By definition, multiplier volumes are volumes that would not have been mailed in the absence of the NSA. The qualitative value of the multiplier effect may be more difficult to assess because, as we have noted, the business is not a negative option business like Bookspan's book clubs. But Mr. Gustafson testified that the vast majority of solicitations sent by Bradford are for series or subscription plans. *Response of Bradford Group Witness Gustafson to Commission Information Request No. 1 , Question 5*, Tr. 2/15. Precise estimation of the multiplier effect is unnecessary. As a qualitative matter, the effect is evident, and the Postal Service did not rely on the financial value of the multiplier in its quantitative analysis of the financial benefits of the deal, and its subsequent determination that the NSA provides the Postal Service with a reasonable opportunity for financial gain.

In sum, the Postal Service has reasonably concluded that it will receive substantial economic benefit from the Bradford NSA, and the Postal Service is taking virtually no risk in that, if economic benefit is not realized, the NSA will automatically terminate or the Postal Service can choose to terminate the agreement at any time.

CONCLUSION

For the reasons provided above, the Commission should recommend the adoption of the proposed NSA and implementing DMCS rate schedules.

Respectfully submitted,

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